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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 728

EDNA B. ELIAS,
Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

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JEREMIAH T. MAHONEY,
Of Counsel.

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INDEX.

PETITION

	PAGE
Opinion Below	2
Jurisdiction	2
Statement	2
Questions Presented	8
Statutes Involved	9
Reasons for Granting the Writ	10

BRIEF IN SUPPORT OF PETITION

Statement	15
Specifications of Errors to Be Urged	15
Summary	17
Argument	17
I—In holding that the petitioner was taxable under sec. 22(a) without the retention by her of any control over the trust funds, the decision of the Court below is in conflict with the decision of this Court in *Helvering* v. *Clifford*.	17
II—In so far as the Court below held that the control factor for the purposes of sec. 22(a), should be inferred from the relationship between the petitioner and the trustee, her husband, notwithstanding that the Board, upon substantial evidence, had found to the contrary, the Court below exceeded its jurisdiction	20

PAGE

III—Sec. 166 of the Revenue Act of 1934 was not applicable to these trusts for the years 1934 and 1935; if construed to be so applicable it would to that extent contravene the Fifth Amendment to the Constitution..... 24

Sec. 166 of the Act of 1934 does not apply where, as in this case, during the tax years the power to revoke was not exercisable but contingent 24

If construed to apply to the present situation where the trusts were created five years before the Act of 1934, Sec. 166 would have a retroactive effect and would impose an arbitrary and unreasonable Tax in violation of the Fifth Amendment to the Constitution 26

IV—The capital gains for 1934 and 1935 were not taxable to the petitioner under Sec. 167; to construe this section in the Act of 1934 to tax such gains to petitioner would give the statute an effect in conflict with the Fifth Amendment. 29

The capital gains for 1934 and 1935 were not taxable to the petitioner under Sec. 167, because in those years it could not be determined who would ultimately become entitled to such gains..... 29

The application of Sec. 167 of the Act of 1934 to the capital gains from these trusts for 1934 and 1935, would give the statute a retroactive effect and would impose an arbitrary and unreasonable tax in contravention of the Fifth Amendment..... 33

CONCLUSION 35

APPENDIX 37

CASES CITED:

PAGE

Altmaier v. *Commissioner*, 116 F. (2d) 162 (C. C. A.—6), Cert. denied 312 U. S. 706.....12, 32

Blodgett v. *Holden*, 275 U. S. 142.....11, 13, 27, 34

Commissioner v. *Barbour*, 122 F. (2d) 165 (C. C. A.—2) 18
Commissioner v. *Buck*, 120 F. (2d) 775 (C. C. A.—2). 18
Commissioner v. *Grosvenor*, 85 F. (2d) 2 (C. C. A.—2) 12, 31
Commissioner v. *Jonas*, 122 F. (2d) 169 (C. C. A.—2). 18
Commissioner v. *Prouty*, 115 F. (2d) 331 (C. C. A.—1) 22
Commissioner v. *Waterbury*, 97 F. (2d) 383 (C. C. A.—2), cert. denied 305 U. S. 638.....12, 29, 30, 31
Commissioner v. *Woolley*, 122 F. (2d) 167 (C. C. A.—2) 18
Commissioner v. *Yeiser*, 75 F. (2d) 956 (C. C. A.—6).21, 22
Corning v. *Commissioner*, 104 F. (2d) 329 (C. C. A.—6) 11, 12, 24, 25, 32

Eisner v. *Macomber*, 252 U. S. 189.....13, 34

Gibbons v. *Mahon*, 136 U. S. 549.....13, 34
Gladding v. *Follett*, 2 Dem. Surr. 58 affirmed 30 Hun 219, affirmed 95 N. Y. 652..... 21
Graff v. *Commissioner*, 117 F. (2d) 247 (C. C. A.—7) 12, 32

Harrison v. *Schaffner*, 312 U. S. 579..... 20
Hassett v. *Welch*, 303 U. S. 303.....11, 13, 27
Helvering v. *Campbell*, 313 U. S. 15.....12, 32
Helvering v. *Clifford*, 309 U. S. 331, 6, 7, 8, 10, 16, 17, 18, 19, 20, 23, 26
Helvering v. *Dunning*, 118 F. (2d) 341 (C. C. A.—4), cert. denied Oct. 13, 1941.....11, 25
Helvering v. *Hallock*, 309 U. S. 106.....12, 32
Helvering v. *Helmholz*, 296 U. S. 93.....11, 13, 27, 34
Helvering v. *Richter*, 312 U. S. 561..... 20

PAGE

Helvering v. *Wood*, 309 U. S. 344 ..... 25, 26
Hoeper v. *Tax Commission*, 284 U. S. 206 ..... 11, 13, 28, 34
Hormel v. *Helvering*, 312 U. S. 552 20

Kent v. *Rothensies*, 120 F. (2d) 476 (C. C. A.—3), cert. denied Oct. 13, 1941 12

Laumeier v. *Laumeier*, 237 N. Y. 357 21
Lyons Estate, 137 N. Y. Supp. 171 21

Nichols v. *Coolidge*, 274 U. S. 531 ..... 11, 13, 28, 34

Reinecke v. *Smith*, 289 U. S. 172 28
Reuter v. *Commissioner*, 118 F. (2d) 698 (C. C. A.—5) 11, 25

Savage v. *Commissioner*, 82 F. (2d) 92 (C. C. A.—3). 21

United States v. *Stroop*, 109 F. (2d) 891 (C. C. A.—6) 12, 29, 31

STATUTES CITED:

Internal Revenue Code:
Sec. 1141(a) 2
Sec. 1141(c) (1) 10, 23, 38

Judicial Code:
Sec. 240(a) 2

Revenue Act of 1919:
Sec. 402(c) 28

Revenue Act of 1924:
Sec. 219(g) 28

Revenue Act of 1926:
Sec. 302(d) 27

Revenue Act of 1928:
Sec. 166 38
Sec. 167 ..... 30, 31, 38

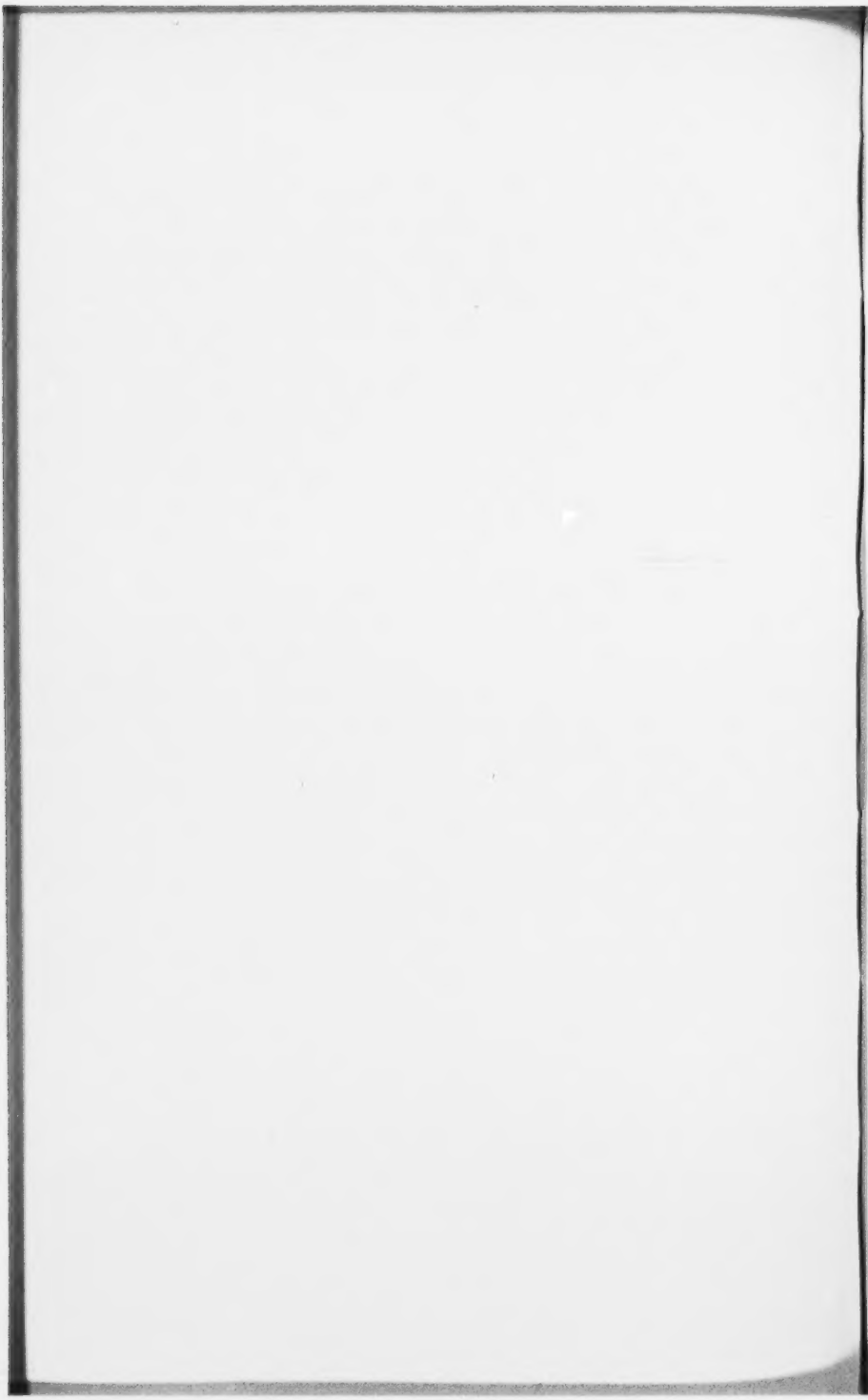
PAGE

Revenue Act of 1932:
Sec. 166 ..... 25, 39
Sec. 167 ..... 31, 32, 34

Revenue Act of 1934:
Sec. 22(a) 6, 7, 8, 10, 15, 16, 17, 18, 20, 21, 23, 25, 37
Sec. 166,
6, 7, 8, 9, 10, 11, 12, 16, 17, 24, 25, 26, 28, 29, 32, 37
Sec. 167 ..... 6, 7, 9, 12, 16, 17, 29, 30, 31, 32, 33, 34, 37

CONGRESSIONAL RECORD CITED:

Vol. 78, pp. 7823-4 39
Vol. 78, pp. 7831-2 40



IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. .

EDNA B. ELIAS,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The petitioner, Edna B. Elias, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Second Circuit, entered in the above cause on August 21st, 1941 (R. 160-1), after denial of a petition for rehearing by order entered on the same day (R. 159-160), affirming on the petitioner's appeal, and reversing on the respondent's appeal, the order of the United States Board of Tax Appeals entered on June 22nd, 1940 (R. 69), which confirmed in part and expunged in part deficiencies in income tax asserted against petitioner for the years 1934 and 1935 (R. 145).

Opinion Below.

The opinion of the Circuit Court of Appeals is reported in 122 Fed. (2d) 171, and printed in the record (R. 145-8). The Opinion of the Board of Tax Appeals is reported in 41 B. T. A. 1109, and printed in the record (R. 52-67).

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on August 21st, 1941, reviewing a decision of the Board of Tax Appeals (R. 160-1).

The jurisdiction of this Court is based upon Section 240(a) of the Judicial Code as amended by the Act of February 13th, 1925, and upon Section 1141(a) of the Internal Revenue Code.

Statement.

This case involves petitioner's asserted tax liability with respect to the income for the years 1934 and 1935 from four trusts created by her.

The findings of the Board of Tax Appeals (R. 52-67), and the provisions of the trust instruments which were received in evidence (in ev., R. 96; printed, R. 115-134), may be summarized as follows:

On July 1st, 1929, in the City of New York, the petitioner, as grantor, executed four deeds of trust whereby she transferred to her husband, Henry Hart Elias, as Trustee, four trust funds of $25,000 each, creating four separate trusts, one for the benefit of each of their four children, Albert Jay Elias, Jose-

phine Elias, Robert Henry Elias and Catherine Elias (R. 53).

The children were all infants then and through the tax years 1934 and 1935, except that Robert Henry Elias attained his majority on September 17th, 1935 (R. 53; 59).

The four trust instruments (received in evidence, R. 96, and printed, R. 115-134) were alike so far as material here (R. 54).

Taking the trust for Albert J. Elias as an example, the husband, the trustee, was empowered to invest the trust fund and collect the income and use and expend the net income, or so much thereof as he in his sole discretion should deem advisable, for the support and education of the beneficiary until the latter should attain his majority, whereupon the Trustee was to pay over to the beneficiary all accumulated and unexpended income of the trust (R. 54; 115-6). Thereafter the annual net income was to be paid to the beneficiary until the death of either the beneficiary or the petitioner at which time the trust was to terminate and the remaining principal was to be paid to the husband to be his absolute property (R. 54; 116). But if the husband should predecease both the beneficiary and the petitioner, the trust was to continue and the annual net income was to be paid to the beneficiary until the death of the beneficiary, whereupon the remaining principal was to be paid over to the petitioner if then living, otherwise to others (R. 54; 116).

It was further provided that during the lifetime of the husband, Henry Hart Elias, he should be the sole trustee with the following powers: absolute discretion as to the character of investments; power to borrow from the trust fund at 4% interest; power to do

everything in the management and investment of the trust fund which an individual can do with his own property (R. 54-6; 117); power to apply and expend such part of the principal as in his (the husband's) judgment should be advisable for the support and education of the beneficiary during the latter's minority, in the event that in his judgment the income should be insufficient for such purpose, and in his sole discretion to make such application and expenditure of the income and of such part of the principal as he should deem advisable, directly to or for the purpose of the support and education of the beneficiary without the intervention of a legally appointed guardian (R. 55; 119).

But such powers were bestowed only upon the husband; they were not to devolve upon any substitute or successor trustee or trustees (55-6; 117; 119-120).

Henry Hart Elias, the husband, was at all times financially able to support the children (R. 60). He had a substantial adverse interest in the disposition of the corpus and income (R. 63).

Substitute trustees were appointed to act in case of the husband's death before the termination of the trust (R. 56-7; 120), but that contingency did not arise, and the husband continued as the sole trustee during the life of the trusts (R. 53).

In each trust instrument it was also provided that the grantor (the petitioner) reserved to herself the right to revoke the instrument at any time after January 15, 1936, upon 30 days' previous notice to the then acting Trustees, and that until said January 15th, 1936, the trust should be absolutely irrevocable (R. 56; 121).

The husband as trustee administered the trusts as valid separate trusts (R. 57).

None of the ordinary trust income (interest and dividends) was ever paid or applied, directly or indirectly to or for the benefit of the petitioner (R. 59).

Such income (interest and dividends) from each trust was deposited in an account kept in the name and for the beneficiary, and so much thereof as the husband deemed advisable was applied to the support and education of the beneficiary, and the unexpended balance was held in such beneficiary account (R. 57-8).

Capital gains were treated as part of principal; they were not segregated, but were intermingled, invested and held with the rest of the principal funds of the trust (R. 57). The capital gains were reported by the husband as income of the trust, and the tax thereon was paid from trust principal (R. 57).

The ordinary income (interest and dividends) was included in personal tax returns filed on behalf of each beneficiary, and the tax thereon was paid from his or her funds (R. 57-8).

When one of the beneficiaries, Robert Henry Elias, attained his majority on September 17th, 1935, all the unexpended income in his beneficiary account was paid over to him, and thereafter all income was paid over to him as it was received from his trust fund (R. 59).

On February 3, 1936, the petitioner gave notice of revocation of the four trusts, which became effective thirty days later on March 4th, 1936 (R. 59).

Thereupon the principal of each trust fund, which included gains on sales theretofore made, was paid over to the petitioner (R. 59). But none of the ordinary income, interest or dividends, was paid to her; on the contrary, all interest received or accrued and all dividends declared or paid on each trust fund prior

to March 4th, 1936, was set apart for the beneficiaries who were still minors, and such income from the Robert Henry Elias trust was paid over to him (R. 59). Thereafter when Josephine Elias attained her majority on December 28, 1938, the balance of the income of her trust was paid over to her (R. 59).

The respondent, in his notice of deficiency, added to the petitioner's returns for 1934 and 1935 the interest, dividends and capital gains for those years, on the ground that the income from these trusts was taxable to her under *Sections 166 and 167* of the Revenue Act of 1934, and asserted against her tax deficiencies of $6,664.68 for 1934 and $6,566.51 for 1935 (R. 21; 23-5; 58).

Upon appeal by petitioner, the Board of Tax Appeals held (R. 60-7):

(1) That the petitioner was not taxable upon the ordinary trust income pursuant to *Section 22(a)* under the doctrine of *Helvering* v. *Clifford,* 309 U. S. 331, because she retained no powers of control over the corpus, since she appointed as trustee not herself, but her husband, vesting in him all powers of management, and he clearly had a substantial adverse interest in the disposition of both corpus and income (R. 61-3);

(2) that petitioner was also not taxable under Section 166 of the Act of 1934, because in the tax years 1934 and 1935 the power of revocation was not exercisable, but was contingent upon the continuance of the trust until after January 15th, 1936, by the survival of herself and the beneficiary, and that hence the power was not vested as required by the statute (R. 64-5); but

(3) that petitioner was taxable upon the capital gains pursuant to Section 167 (R. 65-7).

Accordingly the Board redetermined the tax deficiencies, based upon the capital gains, at $1,612.74 for 1934, and $410 for 1935 (R. 69).

The respondent and the petitioner each appealed to the Circuit Court of Appeals. The Court held (R. 145-8):

(1) That, although the petitioner "surrendered all control of these funds and all income arising from them for a period of six years, six months and fifteen days" (R. 146), nevertheless, viewing these as term trusts for 6½ years, the control factor necessary to bring the case within Sec. 22(a) as construed in *Helvering* v. *Clifford,* was deemed to be present as a matter of law because of the limited period of the trusts (R. 146-7);

(2) that moreover in the present case, from the petitioner's relationship with the Trustee, her husband, it should be inferred that he would comply with her wishes as to the disposition of the trust funds, so that she should be deemed to be in control for the purposes of Sec. 22(a) (R. 147-8);

(3) that since it was decided that petitioner was taxable under Sec. 22(a), it was not necessary to determine whether she was taxable under Secs. 166 and 167 (R. 146); and

(4) that the order of the Board should be affirmed on the taxpayer's appeal, and reversed on the Commissioner's appeal (R. 148; 161).

Questions Presented.

1. Was the petitioner taxable under Sec. 22(a) of the Revenue Act of 1934 upon the income for the years 1934 and 1935 from the trusts here involved, even though petitioner had surrendered all control of these trust funds during the period from July 1, 1929, to January 15, 1936?

2. Was the Court below justified in holding that the petitioner was taxable under Sec. 22(a) of the Revenue Act of 1934 upon the income for the years 1934 and 1935 from these trusts, on the ground that the control factor to bring the case within the doctrine of *Helvering* v. *Clifford,* should be inferred from the relationship between petitioner and the trustee, her husband, notwithstanding that the Board of Tax Appeals, with evidence in support thereof, had found that the husband had a substantial adverse interest in the disposition of both corpus and income, that the petitioner had retained no powers of control over the corpus of the trusts during the period ending January 15th, 1936, and concluded that she was not so taxable pursuant to Section 22(a)?

3. Was the Court below justified in reversing the Board and holding that the petitioner was taxable under Sec. 22(a) of the Revenue Act of 1934 upon the income for the years 1934 and 1935 from the Trusts here involved?

4. Did the Court below err in failing to consider Sec. 166 of the Revenue Act of 1934 and to hold that the petitioner was not taxable under that Section upon the income for 1934 and 1935 from these trusts?

5. Did the Court below err in failing to consider Sec. 166 and to hold that the application to these trusts for the years 1934 and 1935, of Sec. 166 as amended in the Act of 1934, would give the statute a retroactive effect upon a previously closed transaction, and would impose an arbitrary and unreasonable tax, especially with respect to the ordinary income, amounting to the taking of petitioner's property without due process of law in violation of the Fifth Amendment to the Constitution of the United States?

6. Did the Court below err in failing to consider Sec. 167 of the Revenue Act of 1934 and to hold that the petitioner was not taxable under that section upon the capital gains for the years 1934 and 1935 from these trusts?

7. Did the Court below err in failing to consider Sec. 167 of the Revenue Act of 1934 and to hold that the application of that section to tax the petitioner upon the capital gains from these trusts for the years 1934 and 1935, would give the statute a retroactive effect upon a previously closed transaction and would impose an arbitrary and unreasonable tax amounting to a taking of petitioner's property without due process of law in violation of the Fifth Amendment to the Constitution of the United States?

Statutes Involved.

The statutes involved are set forth in the Appendix, *infra,* pages 37-39.

Reasons for Granting the Writ.

1. In holding that, in the case of trusts for six and a half years, such as these were considered to be, the income therefrom for 1934 and 1935 was taxable to the grantor as a matter of law, pursuant to Sec. 22(a), without the retention by the grantor of any control or management of the trust funds, the Court below has decided an important question of Federal law in a way in conflict with the decision of this Court in *Helvering* v. *Clifford,* 309 U. S. 331, *335-6.* There, in sustaining the application of Sec. 22(a) to a five year term trust, this Court emphasized the grantor's retention of legal control of the trust funds as a basic factor in the decision.

2. In so far as the decision of the Court below, that this case came within Sec. 22(a), was based upon an inference from the relationship between the petitioner and the trustee, her husband, notwithstanding that the Board, with evidence in support thereof, had found that the husband trustee had a substantial adverse interest in the disposition of both corpus and income, that the petitioner had reserved no power of control over the corpus and that Section 22(a) did not apply, the decision of the Court is not warranted by the findings of the Board, and the Court below exceeded its jurisdiction by undertaking to decide questions and make findings of fact, a function which is vested in the Board exclusively. *Internal Revenue Code,* Sec. 1141(c); *Helvering* v. *Clifford, supra,* pages *336, 338.*

3. The question as to whether the petitioner was taxable under Section 166 of the Revenue Act of 1934

upon the income for 1934 and 1935 from these trusts, which were revocable six and a half years after their creation provided that the trusts continued so long depending upon the survival of both the petitioner and the beneficiary, is an important question of Federal law, concerning which the Circuit Courts of Appeals are not in agreement. In *Corning* v. *Commissioner,* 104 F. (2d) 329 (C. C. A.—6), it was indicated that Sec. 166 of the Act of 1934 would not apply in such a case. But in *Reuter* v. *Commissioner,* 118 F. (2d) 698 (C. C. A.—5), and *Helvering* v. *Dunning,* 118 F. (2d) 341 (C. C. A.—4), cert. denied Oct. 13, 1941, on slightly different facts a contrary result was reached, although in the latter case the Court distinguished *Corning* v. *Commissioner,* and moreover expressed some doubt as to the constitutionality of applying Sec. 166 to such a situation.

The question has not been but should be settled by decision of this Court.

4. The question as to whether Sec. 166 as amended in 1934 may be applied to tax the petitioner upon the income for 1934 and 1935 from these trusts, created in 1929, without giving the Statute a retroactive effect upon a closed transaction and imposing upon the petitioner an arbitrary and unreasonable tax, especially with respect to the ordinary income, amounting to the taking of her property without due process of law in violation of the Fifth Amendment to the Constitution of the United States, is an important and doubtful question. *Blodgett* v. *Holden,* 275 U. S. 142, *149*; *Hassett* v. *Welch,* 303 U. S. 303, *314*; *Helvering* v. *Helmholz,* 296 U. S. 93; *Nichols* v. *Coolidge,* 274 U. S. 531, *542*; *Hoeper* v. *Tax Commission,* 284 U. S. 206, *215*. Such question has not been but should be settled by decision of this Court.

5. The question as to whether the petitioner was taxable under Sec. 167 of the Act of 1934 upon the capital gains for 1934 and 1935 under the circumstances here disclosed, is a question concerning which there has been some difference and uncertainty in the Circuit Courts of Appeals.

It was indicated that Section 167 would not apply to such a situation as this, in *Commissioner* v. *Waterbury,* 97 F. (2d) 383, *386* (C. C. A.—2), cert. denied, 305 U. S. 638, *Commissioner* v. *Grosvenor,* 85 F. (2d) 2, *3* (C. C. A.—2), and *United States* v. *Stroop,* 109 F. (2d) 891, *894* (C. C. A.—6), which decisions, however, involved Sec. 167 with slightly different language in the Acts prior to 1932. Nevertheless, a similar result involving Section 167 as well as Sec. 166 in the Act of 1934, was reached in *Corning* v. *Commissioner* (*supra*). Subsequently *Corning* v. *Commissioner* was disapproved in *Altmaier* v. *Commissioner,* 116 F. (2d) 162 (C. C. A.—6), cert. denied 312 U. S. 706, which was followed in *Graff* v. *Commissioner,* 117 F. (2d) 247 (C. C. A.—7). But the decisions in the latter two cases seem to have been based upon a misunderstanding of the effect of the decision of this Court in *Helvering* v. *Hallock,* 309 U. S. 106, *Cf. Helvering* v. *Campbell,* 313 U. S. 15, *21, 22.*

Kent v. *Rothensies,* 120 F. (2d) 476 (C. C. A.—3), cert. denied Oct. 13, 1941, where Sec. 167 was held to apply, involved an extreme situation.

The question as to whether Sec. 167 applies to the capital gains under the circumstances here involved, is one which has not been but should be settled by decision of this Court.

6. The question as to whether Sec. 167 of the Act of 1934 may be applied to tax the petitioner upon the

capital gains from these trusts for 1934 and 1935, without giving the statute a retroactive effect and imposing upon her an arbitrary and unreasonable tax amounting to taking her property without due process of law in violation of the Fifth Amendment, is an important and doubtful question which has not been but should be settled by decision of this Court. *Blodgett* v. *Holden* (*supra*); *Hassett* v. *Welch* (*supra*); *Helvering* v. *Helmholz* (*supra*); *Nichols* v. *Coolidge* (*supra*); *Hoeper* v. *Tax Commissioner* (*supra*); *Eisner* v. *Macomber*, 252 U. S. 189, *202-3*; *Gibbons* v. *Mahon*, 136 U. S. 549, *558*.

WHEREFORE your petitioner prays that a writ of certiorari issue directed to the United States Circuit Court of Appeals for the Second Circuit, to review the said judgment, and for such other and further relief as may be just.

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IN THE

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OCTOBER TERM, 1941.

No. .

EDNA B. ELIAS,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Statement.

The statement of the case, the questions presented, reference to the opinions of the Court below and of the Board of Tax Appeals, and the basis of jurisdiction of this Court, have been set forth in the petition. The statutes involved are quoted in the Appendix.

SPECIFICATIONS OF ERRORS TO BE URGED.

The Circuit Court of Appeals erred:

1. In holding that petitioner was taxable under Sec. 22(a) of the Act of 1934, upon the income for 1934 and 1935 from these trusts, even though she re-

served no control or management of the trust funds during the period from July 1, 1929 to January 15, 1936;

2. In holding that, in the case of trusts for six and a half years with income distributed to grantor's family, retention by the grantor of control over the trust funds pending the trust, was not necessary to make the income taxable to the grantor pursuant to Sec. 22(a) under the doctrine of *Helvering* v. *Clifford*;

3. In holding that the control factor to bring the case within Sec. 22(a) should be inferred from the relationship between the petitioner and the trustee, her husband, notwithstanding that the Board had made no finding to such effect but had found to the contrary supported by evidence of an adverse personal interest of the husband;

4. In failing to consider Sec. 166 of the Revenue Act of 1934, and to hold that petitioner was not taxable under that section upon the income for 1934 and 1935 from these trusts;

5. In failing to consider Sec. 166 of the Act of 1934, and to hold that, if construed to tax the petitioner on the income, especially the ordinary income, for 1934 and 1935 from these trusts, the section would to such extent be invalid as a violation of the Fifth Amendment to the Constitution of the United States;

6. In failing to consider Sec. 167 of the Act of 1934 and to hold that petitioner was not taxable under that section upon the capital gains for 1934 and 1935 from these trusts;

7. In failing to consider Sec. 167 and to hold that if construed to tax the petitioner upon the capital gains for 1934 and 1935 from these trusts, the section would to such extent be invalid as a violation of the Fifth Amendment; and

8. In affirming the order of the Board on the taxpayer's appeal, and in reversing it on the Commissioner's appeal.

Summary.

Points I and II of the argument deal with the questions concerning petitioner's tax liability under *Sec. 22(a)*, which was the only section the applicability of which was passed upon by the Court below.

Points III and IV deal with Secs. 166 and 167, in case for the purpose of reviewing the judgment below it should be deemed necessary to consider the applicability of those sections also.

Argument.

I.

In holding that the petitioner was taxable under Sec. 22(a) without the retention by her of any control over the trust funds, the decision of the Court below is in conflict with the decision of this Court in *Helvering* v. *Clifford*.

The Court below agreed with the Board that petitioner "surrendered all control of these trust funds and all income arising from them" until after January 15th, 1936 (R. 146). Nevertheless, viewing these

as trusts for six and one-half years with income distributed in the family (but not to the grantor), the Court took the position that "the failure of the settlor to reserve any control or management of the fund pending the trust was not an important factor" (R. 146), and that "Legal powers of management add very little to such a reversioner's actual control over the fund while the trust lasts" (R. 147).

The Court considered that it was already committed to the proposition, that in the case of a trust for something less than ten years, retention of control over the corpus is not a necessary factor to bring the case within Section 22(a), because the limited period of the trust is considered as a matter of law to give the grantor the equivalent of the required control (R. 146-7), citing its own previous decisions in *Commissioner* v. *Barbour,* 122 F. (2d) 165, *Commissioner* v. *Woolley,* 122 F. (2d) 167, *Commissioner* v. *Buck,* 120 F. (2d) 775, *Commissioner* v. *Jonas,* 122 F. (2d) 169.

In taking that position, the decision of the Court below conflicts with the principles laid down by this Court for such cases in *Helvering* v. *Clifford,* 309 U. S. 331. There, in sustaining the application of Sec. 22(a) to a five year term trust, this Court emphasized the following as necessary elements (at pp. 335 and 336):

> "And where the grantor is the trustee and the beneficiaries are members of his family group, special scrutiny of the arrangement is necessary * * *.
>
> So far as his dominion and control were concerned it seems clear that the trust did not effect any substantial change. In substance his control over the corpus was in all essential respects the

> same after the trust was created, as before. The wide powers which he retained included for all practical purposes most of the control which he as an individual would have.
>
> * * *
>
> Since the income remains in the family and since the husband retains control over the investment, he has rather complete assurance that the trust will not effect any substantial change in his economic position.
>
> * * *
>
> But when the benefits flowing to him indirectly through the wife are added to the legal rights he retained, the aggregate may be said to be a fair equivalent of what he previously had."

If the short duration of the trust had been deemed of itself to be sufficient to supply the control factor, there would have been no occasion for this Court, in the *Clifford* case, to so emphasize the retention of legal control as an essential fact.

The Court below, in saying that "the failure of the settlor to reserve any control or management of the fund pending the Trust *was not an important factor*" (R. 146), expressed a view contrary to that of this Court in the *Clifford* case, where it was said at page 336:

> "In those circumstances (where the income remains in the family group) the *all-important factor* might be retention by him of control over the principal." (Italics ours.)

The rule of the *Clifford* case does not appear to have been changed in later decisions of this Court.

In *Hormel* v. *Helvering,* 312 U. S. 552, the grantor and his wife were in control of the trust funds; but the Board had made no findings as to any adverse interest of the wife nor as to the control for the purpose of the application of Sec. 22(a). The point actually decided there by this Court, was that Sec. 22(a) could be raised for the first time on appeal, and the case was remanded to the Board for further hearing on the merits.

In *Helvering* v. *Richter,* 312 U. S. 561, this Court merely decided the procedural question, and disclaimed any intention of passing upon the merits.

Harrison v. *Schaffner,* 312 U. S. 579, involved a mere assignment of a sum of money payable out of trust income for a year.

Therefore the holding of the Court below that retention of control was not necessary to bring these trusts within Section 22(a), is contrary to the rule prescribed by this Court in the *Clifford* case. Whether such a change is to be made in that important doctrine, is a question which this Court should decide.

II.

In so far as the Court below held that the control factor for the purposes of Sec. 22(a), should be inferred from the relationship between the petitioner and the trustee, her husband, notwithstanding that the Board, upon substantial evidence, had found to the contrary, the Court below exceeded its jurisdiction.

In support of its decision to apply Sec. 22(a), the Court below mentioned the relationship between the

petitioner and the trustee, her husband, and referred to them as "living together in obvious harmony" (R. 147), although the Board had made no finding to that effect.

The Board found that the husband trustee was at all times financially able to support the children, the beneficiaries (R. 60), who were all minors while these trusts were in existence, excepting Robert Henry Elias who attained his majority on September 17th, 1935 (R. 53; 59).

Under the law of New York, since he was able to support their children, the husband alone, and not the petitioner, was personally liable for the children's support. *Laumeier* v. *Laumeier,* 237 N. Y. 357, *364-5*; *Gladding* v. *Follett,* 2 Dem. Surr. 58, affirmed 30 Hun 219, affirmed 95 N. Y. 652; *Lyons Estate,* 137 N. Y. Supp. 171; *Commissioner* v. *Yeiser,* 75 Fed. (2d) 956 (C. C. A.—6), at pages *957, 958; Savage* v. *Commissioner,* 82 Fed. (2d) 92 (C. C. A.—3), at pages *93, 94.*

This point, together with the trust provisions giving the husband power to apply principal as well as income, in his discretion, for the support and education of the beneficiaries (R. 55; 119), furnished a substantial basis for the Board's findings that "the husband clearly had a substantial adverse interest in the disposition of both corpus and income" (R. 63), and that petitioner retained no powers of control over the corpus, leading to the conclusion that she was not taxable under Section 22(a) (R. 62-3).

The assumption of the Court below that petitioner's wishes would be heeded by the trustee, her husband (R. 148), appears to be contrary to its own previously expressed opinion "that she surrendered all control of these funds" (R. 146).

However if the Court meant to say merely that there was no express reservation in the trust instruments, and to leave the way open to a finding that petitioner's relations with the Trustee were such that through him she retained control over the trust funds, the difficulty would be that the Board's finding was to the contrary (R. 63).

The trust provision, and the finding, to the effect that petitioner reserved the right to change the trustees (R. 57; 122), referred to appointing and changing substituted or successor trustees, it did not empower her to remove her husband because he was appointed trustee for life (R. 54; 55; 56; 117; 119; 120). Such was the construction concurred in by the Board and the Court in finding that petitioner reserved no power of control over the corpus (R. 63; 146).

The family relationship between petitioner and her husband, the trustee, might have justified the inference that he would not disregard her wishes, if there had been no countervailing circumstances.

But here the husband's adverse interest to apply income and principal if he thought necessary, to relieve him of his obligation for the children's support, would at least justify, if it did not indeed require, the inference that he would act according to his own judgment or interest. In the face of such adverse interest it certainly could not be assumed *as a matter of law,* that petitioner controlled the Trustee. *Commissioner* v. *Yeiser, supra; Commissioner* v. *Prouty,* 115 F. (2d) 331 (C. C. A.—1), at page *336.*

To weigh the conflicting inferences and to decide which should prevail, and to draw the ultimate conclusion of fact as to whether petitioner had retained

control of the corpus through the trustee and whether in view of all the surrounding circumstances she remained the owner for tax purposes, was the function of the Board.

The Court of review had no power to reverse the Board unless the Board decision "is not in accordance with law". *Inter. Rev. Code, Sec. 1141 (c)(1)*, quoted in the Appendix.

In *Helvering* v. *Clifford* (*supra*), this Court said, at page 336:

> "Our point here is that no one fact is normally decisive but that all considerations and circumstances of the kind we have mentioned are relevant to the question of ownership, and are appropriate foundations for findings on that issue. Thus, where, as in this case, the benefits directly or indirectly retained blend so imperceptibly with the normal concepts of full ownership, we cannot say that the triers of fact committed reversible error when they found that the husband (the grantor) was the owner of the corpus for the purposes of Sec. 22(a)."

And at page 338:

> "The failure of Congress to adopt any such rule of thumb for that type of trust must be taken to do no more than to leave to the triers of fact the initial determination of whether or not on the facts of each case the grantor remains the owner for purposes of Sec. 22(a)."

In the present case the findings of the Board did not support the Court's conclusion that the trusts were within Sec. 22(a), and by undertaking to reverse the Board on questions of fact, the Court exceeded its jurisdiction.

III.

Sec. 166 of the Revenue Act of 1934 was not applicable to these trusts for the years 1934 and 1935; if construed to be so applicable it would to that extent contravene the Fifth Amendment to the Constitution.

Sec. 166 of the Act of 1934 does not apply where, as in this case, during the tax years the power to revoke was not exercisable but contingent.

So far as material here, Sec. 166 of the Revenue Act of 1934 (quoted at length in the Appendix), dealing with revocable trusts, provided:

> "Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—
>
> (1) In the grantor * * *
>
> then the income of such part of the Trust" shall be included in grantor's income.

The Board held that the Section did not apply here (R. 65), citing *Corning* v. *Commissioner,* 104 F. (2d) 329 (C. C. A.—6). There in a case involving the same statute, the settlor had reserved the right to revoke two trusts, exercisable after his father's death with respect to one trust, and two years after his father's death with respect to the other; and the Court held (at p. 332) that Sec. 166 did not apply, because the settlor could not be vested with a power that was not presently nor with certainty exercisable *in futuro,* since a power which is not presently exercisable and may never be capable of being exercised, does not exist.

Congress, in adopting the Revenue Act of 1934, refused the request of the Treasury Department to deal with "term trusts", but amended Sec. 166 by striking out the words *"during the taxable year"*. (*Helvering* v. *Wood,* 309 U. S. 344, *348;* Compare Sec. 166 in the Acts of 1932 and 1934, quoted in the Appendix.) As explained on the floor of Congress and in the Conference Committee Report on the amendment, the change in Sec. 166 was aimed at so-called "year-and-a-day trusts" (see extracts from Congressional Record, quoted in Appendix, pp. 39-40, *infra*).

The "year-and-a-day trusts", were revocable by the grantors upon notice of a year and a day, or revocable in one year upon notice given before the end of the previous year. Such trusts were substantially different from the ones here involved, because those trusts were revocable by the grantors at any time provided that the required notice be given; the condition attached to the power was one within the control of the grantor. Whereas in the present case, for six and a half years, the power was not exercisable but contingent; and during that period the grantor had surrendered all control of the corpus and income, as the Court below recognized (R. 146).

In *Reuter* v. *Commissioner,* 118 F. (2d) 698 (C. C. A.—5) and *Helvering* v. *Dunning,* 118 F. (2d) 341 (C. C. A.—4), cert. denied October 13, 1941, both involving trusts which could be revoked effective after a period of about five years, the view was expressed that such trusts came within Sec. 166 of the Act of 1934. Nevertheless in both of those cases the grantors had reserved control as Trustee, so that they were taxable in any event under Sec. 22(a).

In the *Dunning* case, at pages 343-4, the Court thought that *Corning* v. *Commissioner* (*supra*) was

distinguishable on the ground that there the power was subject to a condition precedent, but finally (at p. 345) resorted to the principles of *Helvering* v. *Clifford,* in order to avoid the question as to the constitutionality of applying Sec. 166 to such a situation, concerning which question the Court expressed some doubt.

In *Helvering* v. *Wood, supra,* this Court did not pass upon the application of Sec. 166 to such trusts as the present ones, but merely dealt with a technical *term trust.*

Thus, the question as to whether Sec. 166 of the Act of 1934, applies in the case of trusts such as these, where the power was not exercisable but contingent for a period of six and a half years, is an important question concerning which there is a conflict or at least uncertainty in the decisions of the Circuit Courts of Appeals; the question has not been but should be settled by decision of this Court.

If construed to apply to the present situation where the trusts were created five years before the Act of 1934, Sec. 166 would have a retroactive effect and would impose an arbitrary and unreasonable tax in violation of the Fifth Amendment to the Constitution.

Since the Trusts were created in 1929, with the ordinary income effectively disposed of to named beneficiaries and with no power in the grantor to alter or revoke the trusts prior to January 15th, 1936, the application of the statute as amended in 1934 to tax the grantor upon the income for 1934 and 1935, would impose an arbitrary and retroactive tax against her with respect to previously closed transactions and upon beneficial interests already transferred to others, without any opportunity on her part to dispose of

her property differently in view of the tax. Such a tax effect has been regarded as a violation of the Fifth Amendment to the Constitution, especially since it would amount to measuring her income tax by reference to the income of others.

In *Blodgett* v. *Holden*, 275 U. S. 142, it was held that gifts made prior to June 2, 1924, were not taxable under the Gift Tax provision of the Revenue Act approved on that date. Four of the Judges held, at page *147*, that so far as the Act undertook to impose a tax on prior gifts, it was arbitrary and invalid under the due process clause of the Fifth Amendment to the Constitution. While the other four Judges, for whom Mr. Justice Holmes wrote the opinion, held that the law applied only to gifts made after the effective date of the Act, at page *149*, saying:

> "* * * the Act should be read as referring only to transactions taking place after it was passed, when to disregard the rule 'would be to impose an unexpected liability that if known might have induced those concerned to avoid it and to use their money in other ways'. *Lewellyn* v. *Frick*, 268 U. S. 232, 251, 252."

See also:

Hassett v. *Welch*, 303 U. S. 303, *314*.

In *Helvering* v. *Helmholz*, 296 U. S. 93, it was held that Sec. 302(d) of the Revenue Act of 1926, would violate the Fifth Amendment, if applied to a transfer in trust made before its enactment, which left no power in the grantor to revoke without the consent of other beneficiaries of the trust.

In *Nichols* v. *Coolidge*, 274 U. S. 531, it was held that Section 402(c) of the Act of 1919 requiring the inclusion, for Estate Tax purposes, of property transferred to take effect in possession or enjoyment at or after death, was invalid as in violation of the Fifth Amendment in so far as it applied to property transferred by a decedent before the passage of the Act, the Court, saying at page 542:

> "An excise is prescribed, but the amount of it is made to depend upon past lawful transactions, not testamentary in character and beyond recall. Property of small value transferred before death may have become immensely valuable, and the estate tax, swollen by this, may leave nothing for distribution. Real estate transferred years ago, when of small value, may be worth an enormous sum at the death.
>
> * * *
>
> This Court has recognized that a statute purporting to tax may be so arbitrary and capricious as to amount to confiscation and offend the Fifth Amendment."

See also:

> *Hoeper* v. *Tax Commission*, 284 U. S. 206, *at page 215.*

Reinecke v. *Smith*, 289 U. S. 172, does not support the application of Sec. 166 in the present case. The *Reinecke* case involved Sec. 219(g) of the Act of 1924 which taxed the grantor where he had the power to revoke in conjunction with anyone not a beneficiary; the Court regarded the possession of the power in conjunction with one not a beneficiary, as equivalent to possession of control by the grantor himself, so that

the section was properly applied even in the case of a trust created before the Act. But the power there involved was presently exercisable, not an inchoate or conditional power as in the case at bar.

Therefore, the question as to whether Sec. 166 of the Act of 1934, may be applied to the trusts here involved, without contravening the Fifth Amendment to the Constitution, is at least a doubtful question which has not been but should be settled by decision of this Court.

IV.

The capital gains for 1934 and 1935 were not taxable to the petitioner under Sec. 167; to construe this section in the Act of 1934 to tax such gains to petitioner would give the statute an effect in conflict with the Fifth Amendment.

The capital gains for 1934 and 1935 were not taxable to the petitioner under Sec. 167, because in those years it could not be determined who would ultimately become entitled to such gains.

In providing that the capital gains should become part of the corpus (R. 55; 118-9), the trust deeds merely followed the local law of New York governing the construction and administration of these trusts. *Commissioner* v. *Waterbury*, 97 F. (2d) 383 (C. C. A. —2), at *page 386*, cert. denied 305 U. S. 638; *United States* v. *Stroop*, 109 F. (2d) 891 (C. C. A.—6), at page *894*.

Sec. 167 of the Revenue Act of 1934 (set forth in the Appendix) so far as material here provided in

substance, that there shall be taxed to the grantor such part of the trust income as

(1) *may, in the discretion of the grantor* or of any person not having an adverse interest, or of the grantor and such person jointly, be distributed, or be held or accumulated for future distribution, to the grantor; or

(2) *is* (absolutely) held or accumulated for future distribution to the grantor.

As to the first condition, relating to *discretionary power* to have income distributed or held or accumulated for future distribution to the grantor:

If the petitioner survived and the trusts continued until after January 15, 1936, then the petitioner by revoking the trusts might become entitled to the capital gains included with the corpus (R. 56; 64).

But in the years 1934 and 1935, such a future contingent right was not the discretionary power to have income "distributed or held or accumulated for future distribution to the grantor" within the meaning of Sec. 167.

In *Commissioner* v. *Waterbury, supra*, where a trust created on August 13, 1929, was revocable after January 1, 1930, and capital gains realized on sales made prior to January 1, 1930, were included with the corpus which the grantor became entitled to receive upon revoking the trust after that date, it was held that such gains were not taxable to the grantor under Sec. 167 of the Revenue Act of 1928, the Court saying at page 386:

> "Moreover, it is not clear it was intended that the grantors could require the trustee to earmark

capital gains and retain them separate from any other part of the trust estate. The power to revoke the trust does not constitute discretionary control over disposition of the income within the meaning of Sec. 167. Revocable trusts are taxed pursuant to Sec. 166, which the petitioner admits is not applicable here.

It is erroneous to assume that because the grantors could acquire the trust property through the exercise of the powers of revocation in future years any income presently retained by the trustee could be taxed under Sec. 167. At all times during 1929 the taxable gains were not the property of the respondents but were the property of the trust."

To the same effect, see *Commissioner* v. *Grosvenor*, 85 F. (2d) 2 (C. C. A.—2), at *page 3; United States* v. *Stroop* (C. C. A.—6), *supra, at page 894.*

The *Waterbury, Grosvenor* and *Stroop* cases were decided under Section 167 of the Revenue Act of *1928* (set forth in the Appendix).

But so far as material here, the only change in *Sec. 167* made by the Act of 1932, which was reenacted without change in the Act of 1934, was to provide that trust income should be taxed to the grantor, where it *is* held or accumulated for future distribution to him, in addition to where it *may in the discretion of the grantor* be distributed, or held or accumulated for future distribution, to him.

Hence, the decisions in the *Waterbury, Grosvenor* and *Stroop* cases, *supra,* establish that in 1934 and 1935 the capital gains were not subject to distribution to petitioner, or held or accumulated for future distribution to her, *in her discretion,* or in the *discretion* of any one not having an adverse interest, within the meaning of Sec. 167 of the Act of 1934.

Therefore it only remains to consider whether in the years 1934 and 1935, it could have been said that the capital gain "*is* * * * held or accumulated for future distribution to the grantor", within the meaning of Sec. 167 as amended in the Acts of 1932 and 1934.

Here, in 1934 and 1935 it could not be said that the capital gains were held or accumulated for future distribution to the petitioner, because in those years it could not be determined who would ultimately become entitled to the corpus.

In *Corning* v. *Commissioner, supra,* where the grantor would have become entitled to accumulated income in the event of revoking the trusts after his father's death, the Commissioner in asserting the deficiency invoked Sec. 167 as well as Sec. 166, of the Act of 1934. Nevertheless, the Circuit Court of Appeals of the Sixth Circuit reversed the deficiency.

In *Graff* v. *Commissioner,* 117 F. (2d) 247 (C. C. A. —7) and *Altmaier* v. *Commissioner,* 116 F. (2d) 162 (C. C. A.—6), cert. denied 312 U. S. 706, a different result was reached under Sec. 167 (of the Acts of 1934 and 1932), in the latter case the Court expressing disapproval of its prior attitude on this question in the *Corning* case. But in so construing Sec. 167 in the *Graff* and *Altmaier* cases, the Court relied upon the decision of this Court in *Helvering* v. *Hallock,* 309 U. S. 106 which, however, involved the estate tax. Subsequently in *Helvering* v. *Campbell,* 313 U. S. 15, this Court pointed out that its decision in *Helvering* v. *Hallock,* involving the estate tax, was not to be applied in construing the income tax.

In *Helvering* v. *Campbell* (*supra*), it was held that, after a legatee had sold, and received the pro-

ceeds of, the securities bequeathed to him, his taxable gain might properly be measured by taking as a basis the value of the securities at the time that he first acquired a contingent interest under the will, this Court saying at page 21:

> "But unlike the situation in *Helvering* v. *Hallock*, 309 U. S. 106, we are not concerned here with the question as to when the transfers took effect for the purposes of the estate tax * * *."

And at page 22:

> "But the tax here in question is not on their remainder interests; it is on gains realized by them as owners of that property. Hence to carry into that computation the earlier value of the property is not to tax them on values which they never received."

In so saying, this Court appears to have recognized that the income tax is not, and cannot be, imposed on values which the taxpayer has not received and which he may never receive depending on future contingencies beyond his control.

In the case at bar, what eventuated in *1936*, could not affect the tax liability for 1934 and 1935.

Therefore, Sec. 167 of the Act of 1934 was not applicable here to the capital gains of 1934 and 1935; at least the question has not been but should be settled by decision of this Court.

The application of Sec. 167 of the Act of 1934 to the capital gains from these trusts for 1934 and 1935, would give the statute a retroactive effect and would impose an arbitrary and unreasonable tax in contravention of the Fifth Amendment.

As observed above, Sec. 167 as it read in the Act of *1928*, was not applicable to the capital gains from these trusts.

If, therefore, the change in the language of Sec. 167, which was first adopted in the Act of 1932 and re-enacted in 1934, be construed to tax this petitioner upon the capital gains from these trusts (created in 1929), the statute would to that extent have a retroactive effect upon a closed transaction in taxing the petitioner upon gains not received by her, without her having any opportunity to change the transfer in trust in view of the subsequently imposed tax burden.

Such an arbitrary retroactive tax result is prohibited by the due process clause of the Fifth Amendment to the Constitution of the United States. (See *Blodgett* v. *Holden, supra; Nichols* v. *Coolidge, supra; Helvering* v. *Helmholz, supra.*)

Moreover, to impose on petitioner an income tax for 1934 and 1935 with respect to capital gains, which in those years were not distributable to her, and of which the ultimate disposition depended on future contingencies beyond petitioner's control, would likewise impose on her an arbitrary and unreasonable tax. *Hooper* v. *Tax Commission, supra;* see also *Gibbons* v. *Mahon,* 136 U. S. 549, at page *558,* and *Eisner* v. *Macomber,* 252 U. S. 189, *at pages 202-3.*

At least the question as to whether Sec. 167 of the Act of 1934 may be applied to the capital gains of these trusts for the years 1934 and 1935, without contravening the Fifth Amendment to the Constitution of the United States, is one involving such doubt that it should be settled by decision of this Court.

CONCLUSION.

For these reasons the petition for the writ should be granted, in order that the important questions of Federal law may be settled by this Court.

Respectfully submitted,

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Of Counsel.

APPENDIX.

Revenue Act of 1934:

SEC. 22. GROSS INCOME.

(a) GENERAL DEFINITIONS—"Gross income" includes gains, profits and income derived from * * * sales or dealings in property whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends * * * or gains or profits and income derived from any source whatever. * * *

SEC. 166. REVOCABLE TRUSTS. Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor.

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse in-

terest in the disposition of such part of the income, be distributed to the grantor; or

(3) (relating to payments on insurance, not material here);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section, the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question."

Internal Revenue Code:

SEC. 1141. COURTS OF REVIEW.

* * *

(c) Powers—

(1) TO AFFIRM, MODIFY, OR REVERSE.—Upon such review, such courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require.

Revenue Act of 1928:

SEC. 166. REVOCABLE TRUSTS. Where the grantor of a trust has, at any time during the taxable year, either alone or in conjunction with any person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor.

SEC. 167. INCOME FOR BENEFIT OF GRANTOR. Where any part of the income of a trust may, in the discre-

tion of the grantor of the trust, either alone or in conjunction with any person not a beneficiary of the trust, be distributed to the grantor or be held or accumulated for future distribution to him, or where any part of the income of a trust is or may be applied to the payment of premiums upon policies of insurance * * *, such part of the income of the trust shall be included in computing the net income of the grantor.

Revenue Act of 1932:

SEC. 166. REVOCABLE TRUSTS. Where at any time during the taxable year the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor * * *

then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor.

Conference Committee Report on the Amendments to the Revenue Act of 1934 (Cong. Rec., Vol. 78, pp. 7823-4):

"Under existing law, the income from a revocable trust is taxable to the grantor only where such grantor (or a person not having a substantial adverse interest in the trust) has the power within the taxable year to revest in the grantor title to any part of the corpus of the trust. Under the terms of some trusts, the power to revoke cannot be exercised within the taxable year, except upon advance notice delivered to the trustee during the preceding taxable year. If this notice is not given within the preceding taxable year, the courts have held that the grantor is not required under existing law to include the trust income

for the taxable year in his return. The Senate amendments require the income from trusts of this type to be reported by the grantor."

In explaining to the House the amendments in the Revenue Act of 1934, agreed to in conference, Mr. Samuel B. Hill, one of the House Managers stated (Cong. Rec., Vol. 78, pp. 7831-2):

"Amendment No. 96: It was found that many taxpayers were avoiding surtaxes by creating trusts in favor of their families which trusts could only be revoked by an advance notice given to the trustee prior to the beginning of the taxable year. This amendment closes up this loophole by taxing such income to the grantor of the trust. We thought this a good way to stop this sort of tax avoidance and agreed to the amendment."

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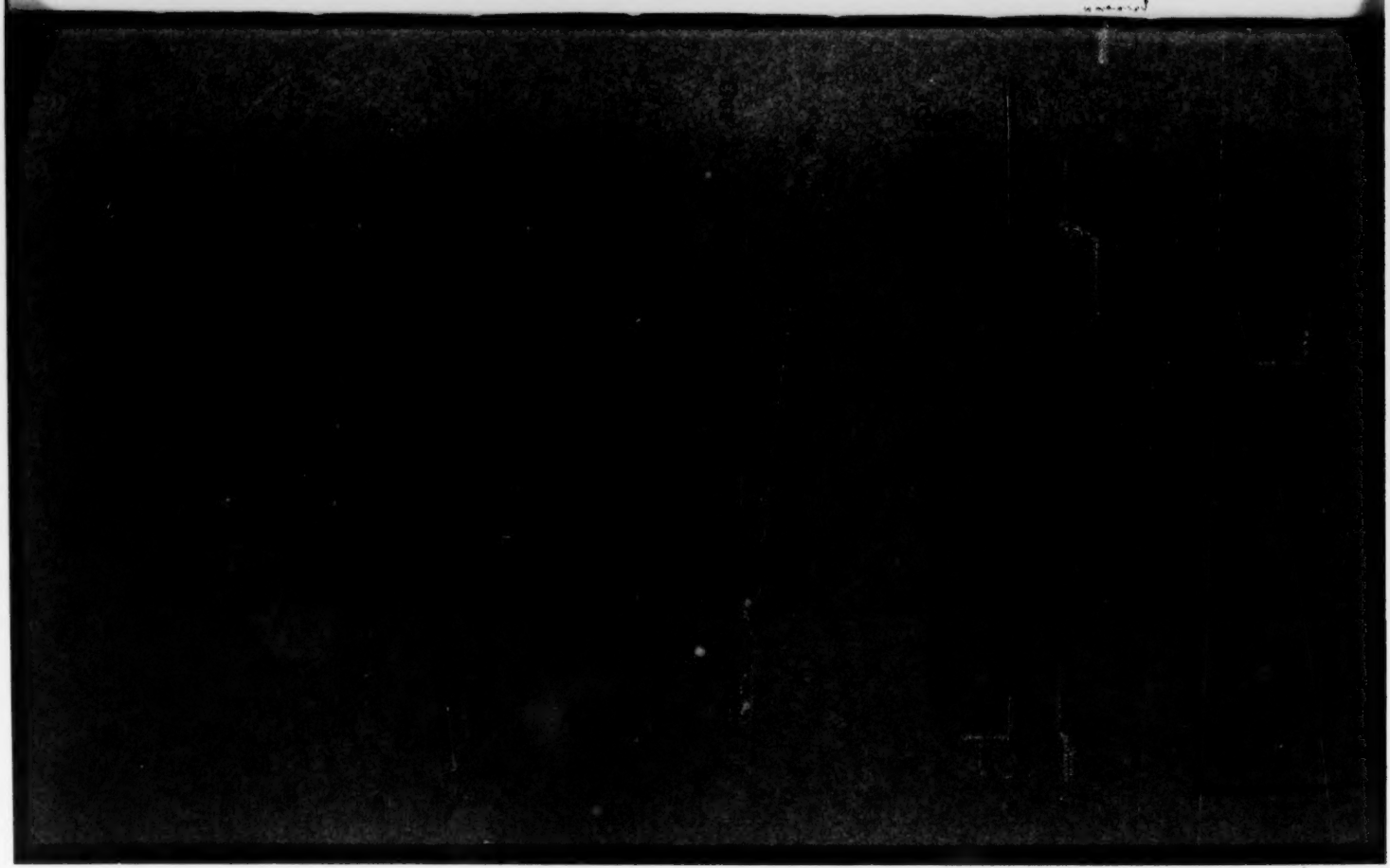

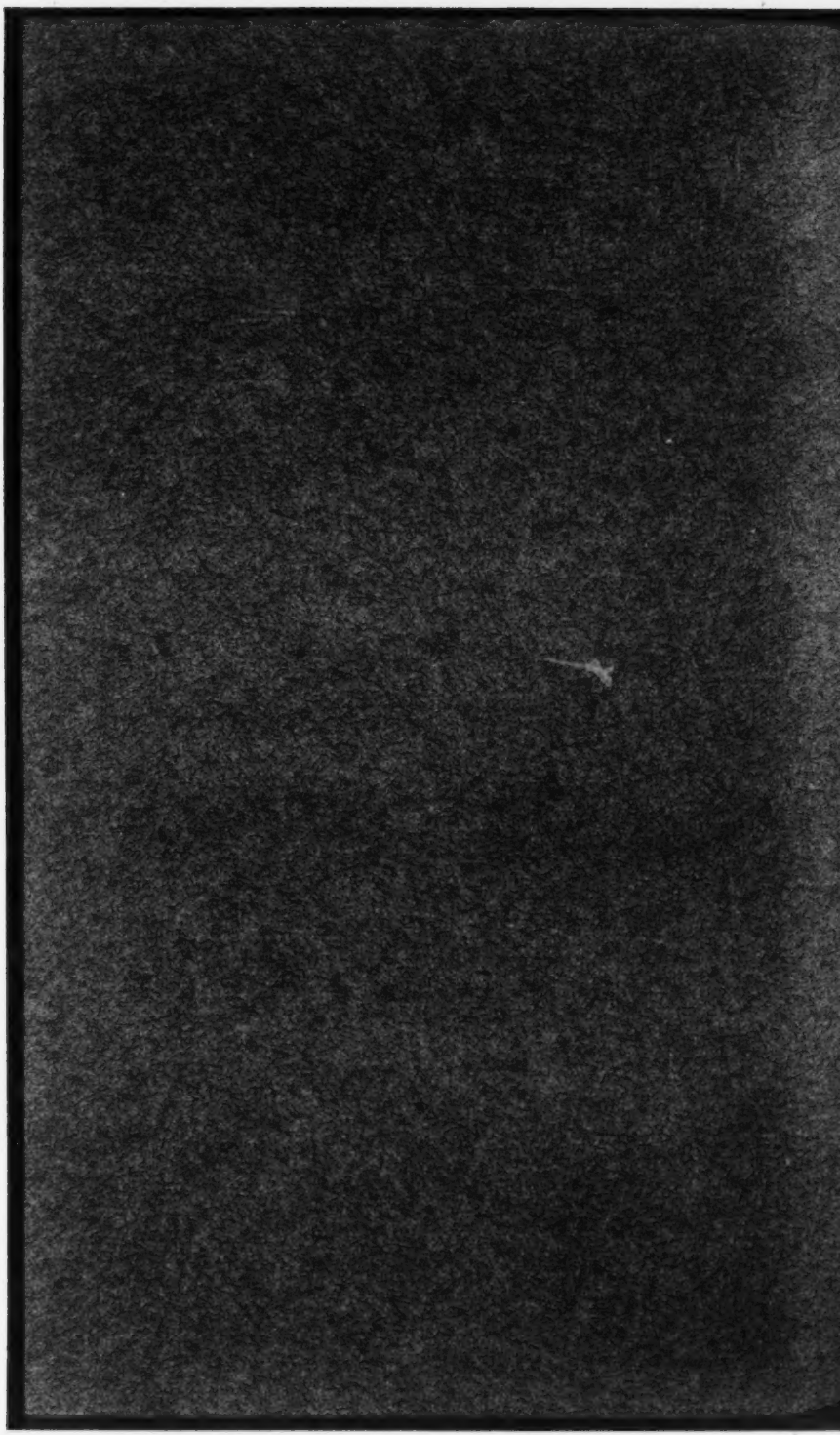

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	1
Statute and regulations involved	2
Statement	2
Argument	6
Conclusion	8
Appendix	9

CITATIONS

Cases:	
Altmaier v. *Commissioner*, 116 F. (2d) 162, certiorari denied, 312 U. S. 706	7, 8
Commissioner v. *Barbour*, 122 F. (2d) 165	6
Commissioner v. *Grosvenor*, 85 F. (2d) 2	8
Commissioner v. *Waterbury*, 97 F. (2d) 383, certiorari denied, 305 U. S. 638	8
Commissioner v. *Woolley*, 122 F. (2d) 167	6
Corning v. *Commissioner*, 104 F. (2d) 329	7
Graff v. *Commissioner*, 117 F. (2d) 247	8
Harrison v. *Schaffner*, 312 U. S. 579	6
Helvering v. *Clifford*, 309 U. S. 331	6, 8
Helvering v. *Dunning*, 118 F. (2d) 341, certiorari denied, October 13, 1941, No. 114, present Term	7
Helvering v. *Eubank*, 311 U. S. 122	6
Helvering v. *Fuller*, 310 U. S. 69	6
Helvering v. *Horst*, 311 U. S. 112	6
Hormel v. *Helvering*, 312 U. S. 552	6
Kent v. *Rothensies*, 120 F. (2d) 476, certiorari denied, October 13, 1941, No. 537, present Term	8
Kraft v. *Commissioner*, 111 F. (2d) 370, certiorari denied, 311 U. S. 671	7
Reinecke v. *Smith*, 289 U. S. 172	7
United States v. *Stroop*, 109 F. (2d) 891	8
Statute:	
Revenue Act of 1934, 48 Stat. 680:	
Sec. 22 (U. S. C., Title 26, Sec. 22)	9
Sec. 166 (U. S. C., Title 26, Sec. 166)	9
Sec. 167 (U. S. C., Title 26, Sec. 167)	9
Miscellaneous:	
Treasury Regulations 86:	
Art. 22 (a)–1	10
Art. 166–1, as amended	11
Art. 167–1, as amended	15

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In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 728

EDNA B. ELIAS, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The majority and minority opinions in the Board of Tax Appeals (R. 52–68) are reported in 41 B. T. A. 1109. The opinion of the Circuit Court of Appeals (R. 145–148) is reported in 122 F. (2d) 171.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered August 21, 1941. (R. 160.) The taxpayer's petition for rehearing was denied August 21, 1941. (R. 159.) The petition for a writ of certiorari was filed November 4, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

In 1929 the taxpayer created four trusts for the benefit of her children, respectively, naming her husband as trustee with

broad powers of control over the trust properties and reserving the right to revoke the trusts at any time after January 15, 1936. She actually revoked them as of March 4, 1936, whereupon the principal, including capital gains, was paid over to her. Is the taxpayer accountable under Sections 22 (a) or 166 of the Revenue Act of 1934 for the entire net income of the trusts for 1934 and 1935? As a further alternative, is she taxable under section 167 on the capital net gains of the trusts for those years?

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set out in the Appendix, *infra*, pp. 9–17.

STATEMENT

The facts found by the Board of Tax Appeals (R. 53–60) may be summarized as follows:

On July 1, 1929, taxpayer, as grantor, and her husband, Henry Hart Elias, as trustee, executed four trust indentures, in which were designated as the respective beneficiaries Albert Jay, Josephine, Robert Henry, and Catherine Elias, children of taxpayer and her husband. All of the children named are still living, and, in the order stated, were born on September 28, 1924, December 28, 1917, September 17, 1914, and July 21, 1919. Henry Hart Elias continued as trustee until the trusts were terminated. (R. 53.)

The four trusts were substantially similar in all respects material here. The instrument establishing the trust for the benefit of Albert Jay empowered the trustee to invest and reinvest the trust fund of $25,000 and any additions thereto; to receive the income and profits therefrom and, after payment of all lawful charges and expenses, to use and expend the net income, or so much thereof as the trustee in his sole discretion might deem advisable, for the support, education, and maintenance of the beneficiary until he reached the age of twenty-one years, when the trustee was directed to pay

over to him all accumulated and unexpended income. Thereafter, the annual net income was payable to such beneficiary until the death of either taxpayer or the beneficiary, at which time it was provided the trust should terminate and the principal fund then remaining be paid over to taxpayer's husband. In the event the husband should predecease Albert Jay and taxpayer, the net income was payable to such first named beneficiary until his death, with remainder over to taxpayer. Additional provisions relate to the disposition of the corpus or principal fund upon the happening of other contingencies. (R. 54.)

It was further directed that during the lifetime of Henry Hart Elias he should be the sole trustee, with absolute discretion as to the character of investments for the trust fund; that he should have full power to sell the same and reinvest the proceeds in such manner as he might deem advisable, and to do everything in the management and investment of the trust fund and property which an individual could do with his own property. (R. 54–55.)

The trust instrument provided that the term "net income" should not include profits realized upon any sale or exchange of trust property, and that any profits or losses upon such sales or exchanges, including stock dividends and profits realized from subscription rights, or any appreciation or depreciation in value, should accrue to and be borne by the corpus or principal of the trust fund. (R. 55.)

Upon termination of the trust, otherwise than by revocation, the funds and property representing such profits and appreciation were to be paid over to Henry Hart Elias, or, if he should then be dead, to the person to whom the principal of the trust was to be paid under other provisions of the trust. (R. 55.)

It was also provided that if at any time during the minority of the beneficiary the net income of the trust, in the judgment of Henry Hart Elias as trustee, should be insufficient for the proper education, support, and maintenance of the beneficiary,

then such trustee was vested with authority to apply and expend for such purposes, in addition to the net income then available, such part of the principal or corpus of the trust as in his judgment should be advisable. (R. 55.)

It was provided that during the minority of the beneficiary, as long as Henry Hart Elias should be living and competent to administer the trust, the net income should be applied and expended as Henry Hart Elias, in his sole discretion, might determine; but, in the event of the substitution of another trustee during minority of the beneficiary, the net income in its entirety should be paid over by the substituted trustee to the legally constituted guardian of the beneficiary. The trust instrument further provided that the absolute discretion given to Henry Hart Elias as trustee respecting the character of investments of the trust fund should not apply to any substituted trustees; that the powers of the substituted trustees and their successors should be only such as are the usual and customary powers of trustees, with certain exceptions. (R. 55–56.)

The trust instrument authorized the husband, as sole trustee, to borrow from the trust fund, for himself and for his own use, in his own discretion, an amount or amounts not exceeding 80 percent of the trust fund, upon such terms as he might deem advisable, upon payment of interest on the sum borrowed at the rate of four percent per annum. The trust instrument further provided (R. 56):

> The party of the first part, the grantor herein of this trust, hereby expressly reserves to herself the right to modify, alter or entirely revoke this instrument at any time after January 15, 1936, as to all or any part of the trust herein created, without the consent of any Trustee or beneficiary hereunder, upon thirty days' previous notice in writing to the then acting Trustees of the grantor's intention to so modify, alter or revoke this trust indenture. Until said 15th day of January, 1936, this trust is absolutely irrevocable. In the event that

> the grantor at any time shall revoke this instrument, the corpus or principal of the trust fund, together with all accumulations and profits and appreciations, shall be immediately paid over by the Trustees to the party of the first part, the grantor herein, or to such person or persons as she may designate.

In event of the death of Henry Hart Elias before termination of the trust, taxpayer, as grantor, appointed a trust company and a certain individual to act as substituted trustees. She also reserved to herself the right to change any or all of the trustees named in the instrument, and to appoint a successor or successors.[1] (R. 56–57.)

On February 3, 1936, taxpayer executed and delivered to the trustee four notices of revocation, revoking each of the four trusts hereinabove mentioned, which revocation became effective thirty days later, on March 4, 1936. (R. 59.)

On or about the date on which revocation of the trusts became effective, the capital or principal of each trust fund, including net gains on sales made prior thereto, as shown on the balance of the capital account of each trust, was delivered and paid over by the trustee to taxpayer. (R. 59.)

The balance of the income then held in the accounts of the respective beneficiaries, including interest received or accrued and dividends received or declared prior to March 4, 1936, was not paid over or delivered to taxpayer, but was transferred to separate accounts of each of the minor beneficiaries, and the unexpended income of the trust for the benefit of Robert Henry Elias, who had theretofore attained his majority, was paid over to him. When Josephine Elias thereafter attained her majority on December 28, 1938, the balance of the income derived from her trust was paid over to her. (R. 59.)

The husband never exercised the power conferred on him to borrow money from any of the four trusts. (R. 59.)

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[1] The Board omits from its findings the provision of the trust instruments (R. 122, 131) to the effect that such successors were to have all the powers of the trustees originally appointed.

The Commissioner included in the grantor's taxable income both the ordinary net income and the capital net gains of the trusts for 1934 and 1935. Upon review the Board held that the taxpayer was accountable for the capital gains but not for the ordinary income of the trusts. Both parties appealed and the court below affirmed the order of the Board on the taxpayers appeal and reversed it on the Commissioner's appeal.

ARGUMENT

1. The court below, following its own prior decisions in *Commissioner* v. *Barbour*, 122 F. (2d) 165, and *Commissioner* v. *Woolley*, 122 F. (2d) 167, held that in "short-term" trusts, which keep the income among members of a family living in amity and dependence, the failure of the settlor expressly to reserve control of the trust property during continuance of the trust [2] is not an important factor, particularly where, as here, the trustee was the husband of the settlor who would not be likely to disregard her wishes in respect to management. We submit that the decision is correct and falls within the scope of this Court's rulings that trusts of this character which are merely temporary reallocations of income within an intimate family group, do not operate to relieve the settlor from the income tax. *Helvering* v. *Clifford*, 309 U. S. 331; *Hormel* v. *Helvering*, 312 U. S. 552; *Helvering* v. *Fuller*, 310 U. S. 69, 76; *Helvering* v. *Horst*, 311 U. S. 112; *Helvering* v. *Eubank*, 311 U. S. 122; *Harrison* v. *Schaffner*, 312 U. S. 579. In the circumstances, we submit that there is no merit to the taxpayer's contention (Pet. 10; Br. 17–23) that the decision below conflicts with *Helvering* v. *Clifford*, *supra*.

[2] The court below did not consider it necessary to pass upon the Government's contention that the settlor had power, under the trust terms, to change any trustee and appoint a successor, such successor to have the same powers as his predecessor. (R. 122, 131; but see R. 117, 120, 127, 129–130.)

2. The tax here involved may also be sustained under Section 166 of the Revenue Act of 1934 (Appendix, *infra*), which provides for the taxation to the grantor of trust income where he has at any time the power to revest in himself title to the trust corpus. Since the grantor in the instant case reserved the right to revoke the trusts and revest in herself title to the trust properties at any time after January 15, 1936, the statute is clearly applicable and it is immaterial that her right might have been defeated by the happening of certain events such as her death prior to that date which did not in fact occur. The situation here is substantially similar to that in *Helvering* v. *Dunning*, 118 F. (2d) 341 (C. C. A. 4th), certiorari denied, October 13, 1941, No. 114, present Term. There, as here, the trusts were created prior to the enactment of Section 166 of the Revenue Act of 1934; and the taxpayer's argument (Br. 24–29) that the law, as so amended, cannot constitutionally be applied in respect to such trusts is clearly unsound. *Reinecke* v. *Smith*, 289 U. S. 172, 175; *Kraft* v. *Commissioner*, 111 F. (2d) 370 (C. C. A. 3d), certiorari denied, 311 U. S. 671. The case of *Corning* v. *Commissioner*, 104 F. (2d) 329 (C. C. A. 6th), relied upon by the taxpayer (Br. 24), is distinguishable on the ground that the power there was contingent upon the death of the grantor's father, while the power here was subject to no such contingency. Moreover, in a later decision (*Altmaier* v. *Commissioner*, 116 F. (2d) 162, 165, certiorari denied, 312 U. S. 706), the *Corning* case was expressly disapproved by the Sixth Circuit itself.

3. The capital gains are also taxable under Section 167 of the Revenue Act of 1934 (Appendix, *infra*), which provides that where any part of the income of a trust is, or in the discretion of the grantor or of any person not having a substantial adverse interest may be, held or accumulated for future distribution to the grantor, then such part of the income of the trust shall be included in computing the net income of the grantor. Here the trustee was required to add the capital gains to corpus and upon revocation they were

payable to her; she thus had command over them and in fact received them in 1936 when she revoked the trusts. The Commissioner's position here is supported by decisions such as *Kent* v. *Rothensies*, 120 F. (2d) 476 (C. C. A. 3d), certiorari denied, October 13, 1941, No. 537, present Term; *Altmaier* v. *Commissioner, supra*, and *Graff* v. *Commissioner*, 117 F. (2d) 247 (C. C. A. 7th). Cases cited by the taxpayer (Br. 29–31), such as *Commissioner* v. *Waterbury*, 97 F. (2d) 383 (C. C. A. 2d), certiorari denied, 305 U. S. 638; *United States* v. *Stroop*, 109 F. (2d) 891 (C. C. A. 6th), and *Commissioner* v. *Grosvenor*, 85 F. (2d) 2 (C. C. A. 2d), were decided under provisions of the 1928 law which are materially different from Section 167 of the Revenue Act of 1934, applicable here. Moreover, those decisions were rendered prior to *Helvering* v. *Clifford, supra*, and they must therefore be viewed now in the light of that decision.

CONCLUSION

The decision below is correct; there is no conflict; the petition should be denied.

Respectfully submitted.

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NOVEMBER, 1941.

APPENDIX

Revenue Act of 1934, 48 Stat. 680:

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(U. S. C., Title 26, Sec. 22.)

SEC. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor. (U. S. C., Title 26, Sec. 166.)

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in

the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o), relating to the so-called "charitable contribution" deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section, the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question." (U. S. C., Title 26, Sec. 167.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 22(a)–1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include

profit gained through a sale or conversion of capital assets. * * *

ART. 166–1 [as amended by T. D. 4629, XV–1 Cum. Bull. 140, 141 (1936), and T. D. 4759, 1937–2 Cum. Bull. 117, 118]. *Trusts, with respect to the corpus of which, the grantor is regarded as remaining in substance the owner.*—(*a*) If the grantor of a trust is regarded, within the meaning of the Act, as remaining in substance the owner of the corpus thereof, the income therefrom is not taxable in accordance with the provisions of sections 161, 162, and 163, but remains attributable and taxable to the grantor. This article deals with the taxation of such income. As used in this article, the term "corpus" means any part or the whole of the property, real or personal, constituting the subject matter of the trust.

(*b*) Section 166 defines with particularity instances in which the grantor is regarded as in substance the owner of the corpus by reason of the fact that he has retained power to revest the corpus in himself. For the purposes of this article the grantor is deemed to have retained such power if he, or any person not having a substantial interest in the corpus or the income therefrom adverse to the grantor, or both, may cause the title to the corpus to revest in the grantor. If the title to the corpus will revest in the grantor upon the exercise of such power, the income of the trust is attributed and taxable to the grantor regardless of—

(1) whether such power or ability to retake the trust corpus to the grantor's own use is effected by means of a power to revoke, to terminate, to alter or amend or to appoint;

(2) whether the exercise of such power is conditioned on the precedent giving of notice, or on the elapsing of a period of years, or on the happening of a specified event;

(3) the time at which the title to the corpus will revest in the grantor in possession and enjoyment, whether such time is within the taxable year or not, or whether such time be fixed, determinable, or certain to come;

(4) whether the power to revest in the grantor title to the corpus is in the grantor, or in any person not having a substantial interest in the corpus or income therefrom adverse to the grantor, or in both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(5) when the trust was created.

But the provisions of section 166 are not to be regarded as excluding from taxation to the grantor the income of other trusts not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the corpus. The grantor is regarded as in substance the owner of the corpus, if, in view of the essential nature and purpose of the trust, it is apparent that the grantor has failed to part permanently and definitively with the substantial incidents of ownership in the corpus.

In determining whether the grantor is in substance the owner of the corpus, the Act has its own standard, which is a substantial one, dependent neither on the niceties of the particular conveyancing device used, nor on the technical description which the law of property gives to the estate or interest transferred to the trustees or beneficiaries of the trust. In that determination, among the material factors are: the fact that the corpus is to be returned to the grantor after a specific term; the fact that the corpus is or may be administered in the interest of the grantor; the fact that the anticipated income is being appropriated in advance for the customary expenditures of the grantor or those which he would ordinarily and naturally make;

and any other circumstances bearing on the impermanence and indefiniteness with which the grantor has parted with the substantial incidents of ownership in the corpus.

Thus the grantor is regarded as being in substance the owner of the corpus if, in any case, the trust amounts to no more than an arrangement whereby the grantor, in the ordering of his affairs, finds it expedient to entrust for a period the title to, and custody or management of, certain of his property to a trustee, the income from such property to be used by the trustee during such period to make those expenditures which the grantor would customarily or ordinarily or naturally make and to which the grantor chooses to commit himself in advance, while the corpus is to be held intact, for return in due course to the grantor. In such a case, it is immaterial that, at the time of the creation of the trust, an irrevocable disposition or consummated gift was made of those property rights which consist of the right to the expected future income of the corpus for the specified period. On the other hand, if the grantor, incident to a definitive and permanent disposition of certain of his property, creates the trust in order to conserve the property not for himself but for the donees, who will ultimately enjoy it, the provisions of sections 161, 162, and 163 are applicable.

(*c*) For example, a grantor is regarded as remaining in substance the owner of the corpus of the trust, if he has placed it in trust for his son, John.

(A) for the term of three years, at the end of which time the trust might be extended for a like period at the option of the grantor and successively thereafter, but in the absence of such an extension the title is once more to revest in the grantor in possession and enjoyment; or

(B) for the term of a year and a day, then to be distributed to whomsoever the wife of the grantor shall by deed appoint (the wife not having a substantial adverse interest in the disposition of the corpus or the income therefrom); or

(C) for the term of the grantor's life, then to be distributed to John, the grantor reserving, however, the right to alter, amend, or revoke any provision of the trust instrument, upon notice of a year and a day.

In these typical cases the grantor is regarded as having retained the substantial incidents of ownership with respect to the income-producing property since the corpus will or may once more revest in himself in (A) upon the expiration of the trust period if the grantor does not exercise his option to extend the trust, in (B) upon the designation of the grantor as distributee, by a person not substantially and adversely interested, and in (C) upon the revocation of the trust instrument or an alteration or amendment thereof, resulting in the designation of the grantor as distributee.

(*d*) If the grantor is regarded as remaining in substance the owner of the corpus the gross income of such corpus shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to the corpus as he would have been entitled to had the trust not been created.

If the grantor strips himself of the substantial incidents or attributes of ownership in the corpus retained by him so that he ceases to be regarded as in substance the owner of the corpus, the income thereof realized after the effective date of such divesting is not taxable to the grantor but is taxable as provided in sections 161, 162, and 163.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the corpus or the income therefrom.

If the power to revest title in the grantor is vested in him in conjunction with such person, or is vested solely in such person, there is to be excluded in computing the net income of the grantor only the income of such part.

ART. 167–1 [as amended by T. D. 4759, *supra*, and T. D. 4860, 1938–2 Cum. Bull. 184]. *Trusts in the income of which the grantor retains an interest.*—(*a*) *Scope.*—Section 167 prescribes that the income, or any part of the income, of certain trusts shall be taxed to the grantor, not because the grantor has retained a certain interest in the *corpus* of the trust (as in section 166), but because of his retention of a certain interest in the *income* of the trust. This article deals with the taxation of such income. The term "income," as used in this article, means any part or the whole of the income of the trust.

(*b*) *Test of taxability to the grantor.*—The test prescribed by the Act as to the sufficiency of the grantor's retained interest in the trust income, resulting in the taxation of such income to the grantor, is whether he has failed to divest himself, both permanently and definitively, of every right which might, by any possibility, enable him to have such income, at some time, distributed to him, either actually or constructively. Such a distribution to the grantor occurs within the meaning of section 167 if the income is paid to him or to another in obedience to his direction or if the income is applied in payment of premiums upon policies of insurance on the grantor's life.

For the purposes of this article, the sufficiency of the grantor's retained interest in the income is not affected by the fact that the grantor has provided that the right to so effect or direct the distribution of income is, or may at some future time be, vested in any person (either

alone or in conjunction with the grantor) not having a substantial interest in the income adverse to the grantor.

If the grantor has retained any such interest in the income, such income is taxable to the grantor regardless of—

(1) whether it may be distributed currently or accumulated for future distribution;

(2) whether such distribution, either current or subject to accumulation, is fixed by the trust instrument or is dependent on an exercise of discretion;

(3) whether, if such distribution is in any way effected by or dependent on an exercise of discretion, the person exercising the discretion is the grantor or a person not having a substantial interest in the income adverse to the grantor, or both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(4) the time or times of such distribution, whether within or without the taxable period, whether conditioned on the precedent giving of notice, or on elapsing of an interval of time, or on the happening of a specified event, or otherwise;

(5) When the trust was created.

Thus the inclusion of any trust within the scope of section 167 is based on the fact that the grantor has retained an interest in the income therefrom by which he is, or may be enabled at some time, to receive its benefits. But the provisions of section 167 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act similarly regarded as remaining in substance the owner of the trust income. If, for example, trust income is applied in satisfaction of the grantor's legal obligation whether to pay a debt, to support dependents, to pay alimony, to furnish maintenance and support, or otherwise, such income is in all cases taxable to the grantor.

If the grantor strips himself permanently and definitively of every such interest retained by him, the income of the trust realized after such divesting takes effect is not taxable to the grantor but is taxable as provided in sections 161 and 162.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the income. There is to be excluded in computing the net income of the grantor only that part of the trust income in the disposition of which such person has a substantial interest adverse to the grantor.

(*c*) *Income and deductions.*—If, as to any of the income, the test of taxability to the grantor is satisfied, such income shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to such income as he would have been entitled had such income been distributable currently to him.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 728.

EDNA B. ELIAS,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

REPLY BRIEF FOR PETITIONER IN SUPPORT OF PETITION FOR CERTIORARI.

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Counsel for Petitioner.

JEREMIAH T. MAHONEY,
Of Counsel.

THE COURT PRESS, N. Y. C.

INDEX.

PAGE

Argument 1

I—The Court below decided that petitioner did not have the power to remove her husband and to appoint a trustee in his place..... 1

II—The respondent's other arguments are dealt with in the petitioner's main brief..... 4

Conclusion 4

TABLE OF CASES CITED:

Dupuy v. *U. S.*, 35 F. (2d) 990 (Court of Claims).... 3

Employers Liability Assurance Corp. v. *Morrow*, 143 Fed. 750 (C. C. A. 6)..... 3

Fleischman v. *Furgueson*, 233 N. Y. 235..... 3

Harrity v. *Continental Eq. T. & T. Co.*, 280 Pa..... 3, 4

Manson v. *Curtis*, 223 N. Y. 313..... 3

Morrill etc. Construction Co. v. *City of Boston*, 186 Mass. 217 4

Pittsburgh & Shawmut R. R. Co. v. *Central Trust Co.*, 156 N. Y. App. Div. 182..... 3

Town of Tonawanda v. *Stapell, Munn & Beals Corp.*, 147 N. Y. Misc. 768..... 3

Wilson & English Construction Co. v. *N. Y. C. R. R. Co.*, 240 N. Y. App. Div. 479..... 3

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Argument.

I.

The Court below decided that petitioner did not have the power to remove her husband and to appoint a trustee in his place.

The respondent asserts (his brief, bottom of p. 6), that the Court below did not consider it necessary to pass upon his contention that the petitioner-grantor had power under the trust instruments to change any trustee and to appoint a successor with the full powers of his predecessor.

But the petitioner submits that it is apparent that on the contrary the Court below did consider that

question and resolved it, in accordance with the rules of construction, against the respondent's contention.

The trust instruments provided (taking the Albert J. Elias trust for example): that the *party of the second part* (the husband) was to use the trust income in his sole discretion for the support of the beneficiary (R. 54; 115); that during the lifetime of Henry Hart Elias (the husband) he should be the sole trustee with the special powers therein described (R. 54; 117); that Henry Hart Elias was given the power to use principal in addition to income, if advisable in his judgment, for the support of the infant beneficiary (R. 55; 119); that as long as Henry Hart Elias should be living and competent to administer the trust, the application of the income and of any principal for the support of the beneficiary was to be made by Henry Hart Elias in his sole discretion, but that in the event of the substitution of another trustee, then the entire net income was to be paid over to the guardian of the beneficiary (R. 55; 119); that if Henry Hart Elias should die before the termination of the trust, then a trust company and an individual were appointed substituted trustees, but the absolute discretion as to investments given to Henry Hart Elias was not to apply to the substituted trustees, the powers of the substituted trustees were to be only such as are the usual and customary powers of trustees (with certain exceptions not material here) and also power in their discretion to retain any of the investments made by Henry Hart Elias (R. 55-7; 120-1).

Then near the end of the instrument, it was provided in general terms (R. 57; 122) that the grantor reserved the right to change any or all of the "Trus-

tees named in this instrument, their successor or successors" and to appoint the successor or successors of said trustees, the said successors to have all the powers conferred upon "The trustees herein appointed by her" (only one trustee had been appointed, Henry Hart Elias).

Clearly the *later general* provision concerning the grantor's right to change the trustees, was not intended to nullify the *prior special* provisions appointing the husband trustee for life and conferring on him the powers therein particularly described. The power to change the trustees related only to changing *substitute* trustees (see R. 97-8).

The fundamental rule in the interpretation of contracts, is to ascertain the intent of the parties as expressed, by considering the whole instrument, and that interpretation is favored which will make every part of the instrument effective. *Manson* v. *Curtis,* 223 N. Y. 313, *320; Fleischman* v. *Furgueson,* 233 N. Y. 235, *239.*

But when two clauses are so inconsistent and repugnant that they cannot stand together, then the rule is that the *first clause will stand* and the last one will be rejected. *Pittsburgh & Shawmut R. R. Co.* v. *Central Trust Co.,* 156 N. Y. App. Div. 182, *189*; *Dupuy* v. *U. S.,* 35 F. (2d) 990 (Court of Claims), *at p. 1002*; *Employers Liability Assurance Corp.* v. *Morrow,* 143 Fed. 750 (CCA—6), *at p. 755.*

Moreover as between conflicting clauses, the *specific or particular one will prevail* over the general one. *Wilson & English Construction Co.* v. *N. Y. C. R. R. Co.,* 240 N. Y. App. Div. 479, *483*; *Town of Tonawanda* v. *Stapell, Munn & Beals Corp.,* 147 N. Y. Misc. 768, *771*; *Harrity* v. *Continental Eq. T. & T. Co.,* 280 Pa.

237, *242*; *Morrill etc. Construction Co.* v. *City of Boston*, 186 Mass. 217, *221*.

Applying these rules the Court below seems to have construed the trust instruments to mean that the grantor's power to change the trustees related only to substituted trustees, not to the husband, because he was appointed to be the sole trustee during his lifetime and he alone was to have the special powers therein described.

For if this were not so, it is difficult to see how the Court could have concluded as it did "that she surrendered all control of these trust funds and all income arising from them for a period of six years, six months and 15 days" (R. 146).

II.

The respondent's other arguments are dealt with in the petitioner's main brief.

CONCLUSION.

The petition for the writ should be granted.

Respectfully submitted,

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